United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

75-7095

To be argued by
EDWARD J. ROSS

United States Court of Appeals

For the Second Circuit

JAY HANDWERGER,

Plaintiff-Appellee,

against

CHARLES GINSBERG, JR., DAVID WEINTRAUB, ABRAHAM WEINTRAUB, ALAN R. CARP, JAMES P. SANDLER, A. THEODORE BARRON, STANLEY FROST, EDWARD GINSBERG, NOAH GOLDBERG, JOHN W. HURLEY, ALLAN LAZAROFF, SANFORD L. ROSENBERG, HEINZ SCHNEIDER, ROBERT B. SLGAL, MARTIN UNGER, AARON WEINTRAUB, HARRY WEINTRAUB, SANITAS SERVICE CORPORATION,

Defendants,

ARTHUR ANDERSEN & CO.,

Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York

REPLY BRIEF FOR DEFENDANT-APPELLANT ARTHUR ANDERSEN & CO.

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Preliminary Statement

The brief of plaintiff-appellee Handwerger ("plaintiff") falls far short of being responsive to the brief of defendant-appellant Arthur Andersen & Co. ("Andersen"), filed March 14, 1975. Plaintiff's brief substantially ignores the essence of Andersen's position as to why Rule 23(b)(3), as amended in 1966, relating to "spurious" class actions

is invalid, namely, because the unprecedented change made as to the binding effect of a judgment abridged, enlarged and modified a substantive right, beyond the Supreme Court's power under the Rules Enabling Act, 28 U.S.C. §2072 (A. Br. 26-31).*

Plaintiff's brief instead relies on the completely erroneous assertion that in *American Pipe & Construction Co.* v. *Utah*, 414 U.S. 538 (1974) and in *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974) (Br. 23, 24), the Supreme Court affirmed the validity of amended Rule 23(b)(3). As shown in Andersen's brief, while such Rule was before the Supreme Court in those two cases, the Court did not even purport to consider its validity, and the argument as to invalidity here urged was not made in either case (A. Br. 21-22). Accordingly, under the principle stated in *Webster* v. *Fall*, 266 U.S. 507, 511 (1925) (A. Br. 22), although such invalidity issue might "lurk in the record" of such two Supreme Court decisions, it cannot "be considered as having been so decided."

Plaintiff's brief, rather than responding directly to the basic ground of invalidity of Rule 23(b)(3), prefers a general argument that class actions are important and protect investors (Br. 14-16),—a position irrelevant to whether such protection should be enacted by the Supreme Court or by Congress. Plaintiff's brief understandably ignores the comments of judges and other authorities who have had the most extensive experience with the actual functioning of Rule 23(b)(3), as amended in 1966, and who have described class actions as "behemoths in the world of litigation" and a "complex, time-consuming and expensive process" (Judge Mansfield, *General Motors*, 501 F.2d at 658); as "legalized blackmail" (Judge Medina, *Eisen III*, 479 F.2d at 1019, quoting Professor Milton Handler); and as a "pressure" device "to induce settlements in large

* "A.Br." refers to Andersen's main brief, filed March 14, 1975. "Br." refers to plaintiff's brief, filed April 15, 1975.

amounts as the alternative to complete ruin and disaster, irrespective of the merits of the claim." (Medina, *Eisen III*, at p. 1019).

While plaintiff may extol class actions as affording "Effective protection of investors" (Br. 16), Judge Friendly,—with his extensive experience with class actions from the standpoint of a Court of Appeals judge in a unique position to appraise the burdens such actions have placed on the courts and counsel, as compared with advantages actually realized,—has stated that "the benefits to the individual class members are usually minuscule" with the class action becoming a mere device for yielding "inordinate" "compensation to the plaintiff's lawyers," through settlements achieved not because of the merits, but because "the possible consequences of a judgment to the defendant are so horrendous." Class actions thereby produce what Judge Friendly also called "blackmail settlements" (Friendly, *Federal Jurisdiction: A General View* (pp. 119-120)).

While the foregoing considerations may be irrelevant to the issue whether the Supreme Court exceeded its statutory power when it promulgated Rule 23(b)(3) in 1966, they are here mentioned only because plaintiff's brief has devoted a separate point to the alleged importance of class actions.

Plaintiff's brief is so unresponsive to the positions urged in Andersen's brief that, but for one factor, Andersen would consider a reply brief unnecessary. The sole issue which warrants reply is plaintiff's position that the order granting class action standing is not appealable.

POINT I

The District Court's order granting class action standing is appealable.

The order granting class action standing is appealable under *Herbst* v. *International Telephone and Telegraph Corp.*, 495 F.2d 1308 (2d Cir. 1974) and *Eisen* v. *Carlisle & Jacquelin*, 479 F.2d 1005 (2d Cir. 1973) ("*Eisen III*"), and also under the Supreme Court's decision affirming *Eisen III*, 417 U.S. 156 (1974).

Plaintiff, however, contends that *Herbst* "runs counter to established appellate decisions"; that *Herbst* was distinguished and narrowed in *Kohn* v. *Royall, Koegel & Wells*, 496 F.2d 1094 (2d Cir. 1974); and that "this Court continued the narrowing process in *General Motors* v. *City of New York, supra*", 501 F.2d 639 (2d Cir. 1974) (Br. 8). Plaintiff also implies that *Herbst* now lacks any "measure of vigor" (Br. 9).

Accordingly, there should first be reviewed this Court's leading decisions which bear on appealability, as well as the Supreme Court's affirmance of *Eisen III*.

A. Review of Recent Decisions on Appealability

(1) *Eisen I.*

Eisen v. *Carlisle & Jacquelin*, 370 F.2d 119, 120, 121 (2d Cir. 1966) ("*Eisen I*"), recognizing that appealability of a class action order is governed by the collateral order doctrine of *Cohen* v. *Beneficial Loan Corp.*, 337 U.S. 541 (1949), held that "the order dismissing this class action is appealable". It added that "Where the effect of a district court's order, if not reviewed, is the death knell of the action, review should be allowed."

Judge Friendly's widely-quoted concurring opinion in *Korn* v. *Franchard Corp.*, 443 F.2d 1301, 1307 (2d Cir.

1971), suggested possible future consideration "*in banc* whether we * * * will afford equality of treatment as between plaintiffs and defendants".

(2) *Eisen III.*

Eisen III held that "the consequences of class action rulings are so serious that these interlocutory orders should be made appealable." Adopting Judge Friendly's suggestion in *Korn* as to "equality of treatment", *Eisen III* also held that the same considerations which led to application of the *Cohen* collateral order doctrine in *Eisen I* "also would seem to require a rule allowing a defendant to appeal from an interlocutory order permitting the representative plaintiff to continue the suit as a class action" (479 F.2d at 1007, fn. 1).

(3) *Herbst.*

Herbst, decided April 3, 1974, reviewed this Court's prior decisions as to appealability and application of the *Cohen* collateral order doctrine to class action orders; considered the volume of class actions pending in this Circuit, noting that it "has probably been plagued by more class actions than any other circuit"; recognized that "other courts of appeal have held that orders authorizing class actions are not appealable and that *Eisen III* was the only decision which sustained appealability under 28 U.S.C. §1291 of an order granting class action status; and concluded "*that Eisen III reached the correct result and we adhere to it*"* (495 F.2d at 1312).

Herbst then squarely held:

> "We believe that immediate review of orders authorizing class actions will aid the district courts in disposing of these cases and *promote the sound administration of justice*" (p. 1312).

* * *

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* Unless otherwise stated, all italics have been supplied.

"[I]t is desirable for us to review orders authorizing class actions before the parties and the district courts expend large amounts of time a d money in managing them" (p. 1313).

* * *

"Judicial efficiency requires that appellate review be made before the parties and district courts have spent considerable time, effort, and money, on such actions" (p. 1313).

* * *

"We think that there ought to be a right to appeal rather than reliance on the discretion of the district court to grant the certificate under 28 U.S.C. §1292(b)" (p. 1313, fn. 9).

Eisen III and *Herbst*,—in upholding appealability of an order granting class standing,—prescribed what Chief Judge Kaufman called "a three-pronged test for appealability of an order granting class standing" (*General Motors Corp.* v. *City of New York*, 501 F.2d at 644). Such test, as described by Judge Lumbard in *Herbst* (495 F.2d at 1312), is whether:

> "[it] clearly involves issues 'fundamental to the further conduct of the case'; . . .
>
> "[and] is also separable from the merits of the case; and [the] irreparable harm to a defendant in terms of time and money spent in defending a huge class action when an appellate court may years later decide such an action does not conform to the requirements of Rule 23, is evident."

As shown below, *Eisen* and *Herbst* have not been overruled by *Kohn* or *General Motors*, on which plaintiff relies for non-appealability. *Eisen* and *Herbst* still represent the rule in this Circuit, adopted with the realization, as stated in *Herbst*, that "other courts of appeals have held that orders authorizing class actions are not appealable" (p. 1312) (pp. 8-10, *infra*). *Kohn* and *General Motors*

merely applied the "three-pronged test for appealability of an order granting class standing", as summarized in *Herbst*, but found that such test was not satisfied in the particular factual situations there presented. And, as also shown below, the Supreme Court, in affirming *Eisen III*, made clear that the rule of appealability adopted in this Circuit is the correct one.*

Herbst, unlike *Eisen*, is a typical securities class action in which a 100 share stockholder claimed misrepresentation in a prospectus and sought to represent other stockholders.

(4) *The Supreme Court decision affirming Eisen III.*

The Supreme Court, in affirming *Eisen III* (417 U.S. 156), on May 28, 1974, upheld the aspect of this Court's decision which had sustained appealability of an order permitting a suit to proceed as a class action (pp. 169-170):

> "At the outset we must decide whether the Court of Appeals in *Eisen III* had jurisdiction to review the District Court's *orders permitting the suit to proceed as a class action* and allocating the cost of notice. Petitioner contends that it did not. Respondents counter by asserting two independent bases for appellate jurisdiction: first, that the *orders* in question constituted a 'final' decision within the meaning of 28 U.S.C. §1291 and were therefore appealable as of right under that section; and second, that the Court of Appeals in *Eisen II* expressly retained jurisdiction pending further development of a factual record on remand and that consequently no new jurisdictional basis was required for the decision in *Eisen III*. *Because we agree with the first ground asserted by respondents, we have no occasion to consider the second*" (417 U.S. at 169-170).

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* The decisions of the "other courts of appeals" which "have held that orders authorizing class actions are not appealable" were all decided before the Supreme Court's affirmance of *Eisen III*.

The Supreme Court thus unequivocally agreed "with the first ground asserted by respondents", namely, that the Court of Appeals had jurisdiction over the District Court "orders",—using the plural,—and described the first such order as one "permitting the suit to proceed as a class action" and the second as one "allocating the cost of notice".*

(5) *Kohn* v. *Royall, Koegel & Wells.*

Kohn was decided on May 3, 1974, one month after *Herbst*, but 25 days before the Supreme Court's affirmance of *Eisen III*.

Kohn neither rejected nor narrowed *Herbst*. *Kohn* specifically recognized that in *Herbst* "the question of appealability of an order granting class standing was squarely presented" (p. 1098). *Kohn* decided on non-appealability "[W]ithout questioning the validity of *Herbst*" (p. 1095) and "without reconsidering at this time the wisdom of *Herbst*" (p. 1099). *Kohn* merely restated and reaffirmed the "three-pronged test for appealability of an order granting class standing" and held that "Applying to this case the same three criteria which combined to favor appealability in *Herbst*, we reach the opposite conclusion here" (p. 1099).

Kohn involved charges against a law firm of sex discrimination in recruitment of lawyers and internal employment procedures, and sought both mandatory injunctive relief and damages for plaintiff caused by such firm's refusal to hire her. As to the first prong, *Kohn* found that

* In *General Motors Corp.* v. *City of New York*, 401 F.2d 639 (2d Cir. 1974) (more fully discussed, *infra*, pp. 9-10), this Court appeared to misinterpret such affirmance. The opinion there states (p. 646, fn. 14) that "our brother Mansfield * * * has apparently overlooked the most critical aspect of the [*Eisen*] case with respect to appealability—its holding which limits that determination to the notice question." It is respectfully suggested, as shown in the text of this brief, that the Supreme Court's decision in *Eisen* was not limited "to the notice question", but also affirmed the order "permitting the suit to proceed as a class action".

the class action determination,—which was under Rule 23 (b)(2), not Rule 23(b)(3),—was "not 'fundamental to the further conduct of the case' ", and that the law firm "appearing *pro se*, conceded at oral argument that Kohn could reasonably be expected to continue the action in her individual capacity" (p. 1099). The precise relief Kohn sought of a mandatory injunction and "damages for herself" (p. 1096) would be the same, whether it was an individual or class action.

Kohn then held as "to the second factor * * * that review of Judge Lasker's order would take us *far into the merits* of Kohn's sex discrimination charge" (p. 1100), necessitating examination of such firm's "hiring and internal employment procedures" to determine possible existence "of a discriminatory pattern and practice" which is "at the very heart of the merits" (p. 1100).

Kohn also found, as to the third factor, that "the incremental cost and time in defending the particular action if it is maintained as a class action" would be insignificant (p. 1100).

(6) *General Motors Corp.* v. *City of New York.*

General Motors was decided on June 28, 1974, one month after the Supreme Court affirmed *Eisen III*. This Court did not there reject or narrow *Herbst*. On the contrary, it reaffirmed that an order which could be deemed interlocutory, in the sense of not finally terminating the action, would under the *Cohen* collateral order doctrine be "appealable as a 'final' order pursuant to 28 U.S.C. §1291" (p. 644). This Court there also reaffirmed the "three-pronged test for appealability of an order granting class standing" which it had "distilled from previous decisions of this Court",—citing both *Herbst* and *Kohn* (p. 644).

Applying such "three-pronged test", appealability was denied *"in the context of this case"* (p. 641), because, "Here, as in *Kohn*, none of these requirements has been met" (p. 644).

Clearly, in *General Motors* the first test of whether the class action determination was "fundamental to the further conduct of the case",—that is, whether the action would cease to be viable if denied class action status,—was not satisfied "[S]ince it is undisputed that the City [the plaintiff] with its $12,000,000 claim would continue this action were class standing denied" (p. 645).

The "second prong of the appealability test" was not "fulfilled for, as in *Kohn*, review of the court's class action determination would take us *far into the merits* of the City's antitrust claim that GM has monopolized or attempted to monopolize a nationwide market in the manufacture and sale of city buses" (p. 645). Finally, the third prong of the appealability test,—irreparable harm to defendant in terms of time and money spent in defending a huge class action,—was not met, because the class was only 177, which "does not remotely approach the thousands * * * encountered in * * * *Herbst*" (p. 646).

B. Application of the "Three-Pronged Test" Supports Appealability of the Order Granting Class Action Standing.

Plaintiff's brief,—recognizing that in this Circuit appealability depends on applicability of the "three-pronged test",—seeks to establish, primarily by *ipse dixit*, inapplicability of all three prongs. However, as herein demonstrated, each of the three prongs is fully satisfied.

(1) *The First Prong—Whether the Class Action Issue Is "Fundamental to the Further Conduct of the Case"*

The class action issue is deemed "fundamental to the further conduct of the case", as recognized in plaintiff's brief, if despite denial of class action status, plaintiff's damages are "sufficiently substantial, so that there is a likelihood that the action will continue in any event" (Br. 9).

Plaintiff Handwerger, owner of a $5,000 Sanitas debenture, argues that his "claim is substantial, since his damages approximate $5,000" (Br. 10),—as though the test of viability is measured by the face amount of his debenture. But plaintiff's damage would be $5,000 only if Sanitas was so hopelessly insolvent that nothing remained for creditors. The record shows that Sanitas may simply be on the verge of insolvency, since its stock was bid at 37¢ a share, so that its assets are obviously sufficient to cover a major portion of debts (58A).

Plaintiff's damages would, at the most, be the difference between the $5,000 face amount of his debentures and its actual value, based on the assets available for debts. While this is speculative, it is necessarily substantially under $5,000.*

Plaintiff's damages are substantially less than Herbst's, who owned 100 shares of Hartford Fire Insurance Co. stock, which she exchanged for 100 shares of ITT Series N preferred stock. If the test is value of the securities, as plaintiff here appears to suggest, then in September 1972, when Herbst commenced her action, the ITT stock exchangeable for her Hartford stock was selling at between $69 and $62 dollars a share,** representing a value up to $6,900,—an amount in excess of Handwerger's $5,000 debentures.

Plaintiff, to establish viability of his action, absent class action status, asserts that "he fully intends to continue the prosecution of this action" (Br. 10). However, it is self-evident that, absent a class action, this would not be a viable case. Assuming that the test were not plaintiff's actual damage but the $5,000 face amount of his debentures, even this amount is less than the printing bill on this appeal alone; is less than the anticipated cost of the transcripts of depositions; and is but a fraction of the out-of-pocket

* His lawyer's affidavit states that debentures were bid at $150.00 per $1,000.00 face amount (58A).

** Quotations, N.Y.S.E., September, 1972.

disbursements which plaintiff will necessarily personally incur.*

Plaintiff Herbst,—faced with the same problem as plaintiff Handwerger of showing intent to continue prosecution of the action, though the litigation costs would necessarily substantially exceed her maximum conceivable recovery,—urged a somewhat more plausible argument than plaintiff Handwerger could here muster. She there argued her intent to continue the action, despite the small amount involved, because the case involved the widely publicized Hartford-ITT transaction, which had become so significant in Watergate.** This argument, however, did not suffice to satisfy this Court that the action would be viable as a non-class action, and the first prong was there held to be satisfied.

Plaintiff Handwerger lacks even such an argument to support his position that the insignificant damage he suffered from possible decrease in value of his $5,000 debenture would make this a viable suit, as a personal action. With the mounting cost of litigation disbursements alone, it is unrealistic for this Court to accept a bare statement from plaintiff that he would continue this action, absent class action status.

Were this Court to adopt a dollar figure for determining whether a plaintiff, denied class action status, might have a sufficient stake in the action to render it viable, such figure should not be less than the $10,000 jurisdictional amount in diversity actions and actions involving federal questions (28 U.S.C. §§1331, 1332).

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* Under *The Code of Professional Responsibility*, "the ultimate liability for such costs and expenses must be that of the client" (EC 5-8); "the client remains ultimately liable for such expenses" (DR 5-105(B)).

** Herbst's memorandum in support of her motion to dismiss the appeal argued that "this case is one which will not be extinguished even if the class action order is reversed", because of the "wide-spread publicity"; "the national spotlight" on the case; the fact that it has been "the subject of numerous newspaper articles, which appear almost daily"; and the wide "public interest" (p. 18).

(2) *The Second Prong—Whether the Class Action Issue Is "Separable From the Merits of the Case"*

To meet the second prong, plaintiff again relies solely on bare assertion that Andersen's "contentions here require a determination of issues closely intertwined with the merits of the action,"—without attempting to identify any issue on this appeal even remotely related to the merits.

As shown in Andersen's main brief (p. 6), plaintiff claims that the merits turn on "only a single issue," namely, Sanitas' alleged failure to disclose that the partnership to which it had sold Economy Linen "was in reality a limited partnership".* This "single issue" as to the merits has no conceivable relationship to any class action issue here presented.

Furthermore, the applicable consideration under the second prong, as stressed in both *Kohn* and *General Motors*, is whether review of the class action order "would take us *far into the merits*" (*Kohn*, p. 1100; *General Motors*, p. 645). Here, the merits of the alleged non-disclosure of sale to a limited partnership lacks any relationship to any element involved in the class action order. Judge Werker, in making his determination, gave no consideration to the merits (59A-64A). Clearly, review of his order is entirely "separable from the merits".

(3) *The Third Prong—Whether Andersen Would Suffer Irreparable Harm in Defending a Huge Class Action Which Might Later Be Held on Appeal Not to Be in Conformity With Rule 23*

To satisfy the third prong, plaintiff again employs mere *ipse dixit* that "Andersen will spend no unusual sums in defending this action as a class action rather than a private action" (Br. 10). This is clearly not true. A private action

* Plaintiff's Reply Memorandum in Support of His Motion for Class Determination, received November 27, 1974 (pp. 6-7), quoted more fully in Andersen's main brief (p. 6). While plaintiff claims that "Andersen has misconstrued the thrust of the complaint" (Br. 33), Andersen merely accepted plaintiff's own statement in the District Court as to such thrust,—a statement he now seems to regret.

by this same plaintiff could be defended and readily disposed of with a minimum of time, expense and effort.

As already noted (p. 13, *supra*), plaintiff claims that his case involves "only a single issue", namely, alleged non-disclosure that the buyer of Economy Linen "was in reality a limited partnership"; that he was misled when he bought his $5,000 debenture because not told that the buyer was a limited partnership; and that he suffered damages, which must be the difference between $5,000 and the debentures' value when plaintiff filed suit.

Andersen should readily be able to dispose of such a case, if brought as a private action, on summary judgment, since the undisputed facts, supported by documentary evidence, establish that the 8-page proxy statement received by plaintiff fully and repetitiously disclosed that the buyer was a limited partnership (A.Br. 7-8; 25A-4-5). No court could conceivably credit the excuse that plaintiff, a lawyer for 16 years, was defrauded because, as he testified, the disclosure of which he complains was "in the rear portion" of the proxy statement and he could not "remember reading that particular portion"* (25A).

It is also Andersen's position that plaintiff, related by marriage to David Weintraub, Sanitas' President and Chief Executive Officer, bought his $5,000 of debentures on the basis of inside information,—relied on by Andersen to disqualify plaintiff as a class representative (21A-22A). Plaintiff testified that he periodically discussed "Sanitas business or its prospects" "at family functions" (21A), and that shortly before he bought his debentures, he "had occasion to discuss the business and prospects of Sanitas with Mr. David Weintraub" (22A-23A).**

* This specious excuse is repeated in plaintiff's brief, which states that the disclosure that the buyer "was a limited partnership was *buried* at the end" of the proxy statement (Br. 4, fn. 3, 33).

** A decision of this Court filed late yesterday afternoon, *Bersch* v. *Drexel Firestone, Inc.*, Docket No. 75-7038 (decided April 28, 1975), indicates that an "insider" may not be a class representative in a situation where "separate proof of reliance, materiality, and causation may be required for each class member" (p. 34, fn. 52, not yet in slip opinion).

Plaintiff's claim as to Andersen, in regard to such alleged non-disclosure that the buyer was a limited partnership, is covered in the complaint by the catch-all allegation that "Each of the defendants * * * aided and abetted" issuance of the proxy statement, with its "false and misleading statements" (8A, A. Br. 18).

Andersen, of course, would also have the defense in a private action that, as accountants, it was in no position to determine whether the facts as to the purchase of Economy Linen by a limited partnership should be stated at the beginning of the proxy statement, so as to assure that plaintiff would read them, or on the 7th and 8th pages, with attendant risk he might not read so far.

This Court has "repeatedly held that mere negligence on the part of the defendants will not support a claim for damages under Section 10(b)" (*Mariash* v. *Morrill*, 496 F.2d 1138, 1145, fn. 13 (2d Cir. 1974)). "Proof of a willful or reckless disregard for the truth is necessary to establish liability under Rule 10b-5" (*Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1306 (1973). Clearly plaintiff's grievance based on the fact that the disclosure was made in the latter portion of the proxy statement hardly meets such standards for Rule 10b-5 liability, especially as against an accounting firm charged as an aider and abetter.*

Accordingly, on plaintiff's own statement as to what his case is all about, it is clear that if brought as a private action to recover his small personal damages, it could be disposed of promptly, effectively and at a minimum of time and effort. And were Andersen disposed to pay tribute to be rid of this litigation, a Rule 54 judgment or a Rule 68 offer of judgment covering the full amount of plaintiff's claim could forthwith end the case.

* To show possible merit to his cause of action, plaintiff asks this Court to take judicial notice that on April 10, 1975, the SEC sued Sanitas in the District of Columbia, "alleging the same misrepresentations and omissions alleged in the complaint herein, among others" (Br. 2). Without detailing the substantial differences between the SEC action and this action, it should suffice to note that the SEC did not make Andersen a defendant,—a fact significant to the merits of any claim against Andersen.

On the other hand, as a class action, the situation is substantially different. This is indeed "a huge class action."* As alleged in the complaint, "The class consists of many thousands of persons" (4A, ¶8), and the potential claim, based on plaintiff's theory, could aggregate $62,000,000 to $66,300,000.** Andersen would become embroiled in the myriad aspects of class action administration, with its "onerous and time-consuming duties not characteristic of most other litigation", so cogently described in Judge Mansfield's concurring opinion in *General Motors*, 501 F.2d at 658. Also, as there recognized (p. 657), any substantial class action can present "the likelihood that because of the sheer size and complexity of the action, the added time, expense and effort needed to defend it as a class suit may force the defendant, despite the doubtful merit of the claims, to settle rather than to pursue the long and costly litigation route required for review of the class action certification."

The third prong of the "three-pronged test" is completely satisfied.

* To avoid this aspect, plaintiff, without reference to the record, asserts that "the class here is only a small fraction of the size of the Herbst Class" (Br. 10, fn. 7),—a clearly false statement. The *Herbst* class was "estimated to approximate 16,000 persons" (p. 1320, fn. 5), whereas the complaint herein alleges that "The class consists of *many thousands of persons*" (4A, ¶8); "many thousands" cannot be "only a small fraction" of 16,000.

** The complaint alleges that "Sanitas had approximately 8,300,000 shares of common stock and $8,200,000 in convertible debentures outstanding" (4A, ¶8). Since at the time of the alleged misrepresentation, the Sanitas stock, which traded on the American Stock Exchange, was selling at $7 a share, or $58,100,000 for the outstanding shares, such amount, added to the debentures, results in total securities outstanding of $66,300,000 in a class action, as compared with plaintiff's $5,000 debentures. According to plaintiff's lawyer, as of October 25, 1974, the common stock was offered at $.37 a share, with no buyers, and the bid for debentures was approximately $150.00 per $1,000 face amount (58A). This would make the stock worth $3,071,000, instead of $58,100,000, a decrease of $55,029,000, and the debentures worth $1,230,000, instead of $8,200,000, a decrease of $6,970,000. The total damages which Andersen might thus face in a class action is $61,999,000, plus interest.

C. Plaintiff's Miscellaneous Contentions as to Non-Appealability Are Specious.

(1) To suggest a concensus that the order is not appealable, plaintiff states that there are 19 named defendants; that 18 opposed plaintiff's motion for class determination; and that "only Andersen has taken an appeal" (Br. 1). However, there are only two appearances in this action, Andersen, and the 17 other defendants* all represented by one firm. Such firm's decision not to appeal was in the interest of saving expense, since its clients would benefit if Andersen's appeal prevails.

(2) Plaintiff argues that "Andersen has acknowledged that the order below should not be considered as a 'final order' ", under §1291 or *Herbst*, because Andersen moved "for an order certifying an interlocutory appeal pursuant to 28 U.S.C. §1292(b)",—a motion being held in abeyance by the District Court pending decision on this appeal.

This is absurd. Every appeal from an order of class determination is automatically resisted on assertion of alleged non-compliance with the three-pronged test. Andersen, though convinced of appealability under §1291, sought a §1292(b) certification through abundance of caution. This dual approach is a common one. It was sanctioned in *Gillespie* v. *U.S. Steel Corp.*, 379 U.S. 148, 154 (1964), which recognized the duality of approach between a §1292(b) and a §1291 appeal and indicated that they "implemented the same policy". In *Shayne* v. *Madison Square Garden Corp.*, 491 F.2d 397, 400 (2d Cir. 1974), this Court noted the "suggestion—in our court and elsewhere—that 28 U.S.C. §1292(b) might be available for appeals from orders deciding class action status", and cited a number of decisions in which §1292(b) appeals were allowed, "generally without discussion of the §1292(b) issue."

* One defendant, A. Theodore Barron, appears simply to ignore all proceedings in this case.

Herbst, recognizing availability of the dual approach, expressed preference for "a right to appeal rather than reliance on the discretion of the district court to grant the certificate under 28 U.S.C. §1292(b)" (p. 1313, fn. 9).

In *Kohn*, where the defendant both moved for an order "to permit certification as an interlocutory appeal, pursuant to 28 U.S.C. §1292(b)" (p. 1096), and also appealed under §1291, there was no suggestion that the certification motion constituted an admission of non-appealability under §1291.

(3) Finally, plaintiff stresses that the order is tentative and conditional, and therefore not appealable, because the District Court reserved "the right to amend or designate subclasses in the event that proves necessary" (63A), and, accordingly, "retains the power to reconsider class status as the action proceeds" (Br. 7). However, every class action determination order "may be altered or amended before the decision on the merits" (Rule 23(c)(1)), so that such power to alter or amend exists by virtue of the rule itself, and regardless of whether a provision to such effect is included in the District Court's opinion or order. Were an order of class determination rendered non-appealable because of the District Court's power to alter or amend before decision on the merits, then every order of class determination would *ipso facto* be non-appealable, despite the clear and unequivocal statement in *Herbst* as to appealability and despite full compliance with the "three-pronged test".*

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* The *Herbst* order, set forth in Judge Danaher's concurring opinion, states that it "is subject to future modification by this court and may be altered or amended prior to decision on the merits" (495 F. 2d at 1325, ¶2). Existence of this provision, which merely incorporated the power contained in Rule 23(c)(1), did not prevent this Court from holding in *Herbst* that there should be "immediate review of orders authorizing class actions" (p. 1312).

POINT II

This Court should adopt a rule of appealability based on application of the collateral order doctrine of *Cohen* v. *Beneficial Loan Corp.*, rather than applying the "three-pronged te[illegible]" on an *ad hoc* basis.

A. This Court Should Adopt a Rule of Appealability Which Will Avoid *Ad Hoc* Judgments in Each Case.

In *Korn* v. *Franchard Corp.*, *supra*, 443 F.2d at 1307, Judge Friendly stated that he "might wish on some subsequent occasion to request that the court consider *in banc* whether we are not obliged to formulate a rule that will avoid the necessity of making such *ad hoc* judgments as have been required in these and other cases." He added, however, that before such occasion, this Court may "have received enlightenment from the Supreme Court." Since such "enlightenment from the Supreme Court", anticipated in its review of *Eisen III*, has apparently not been as clear as desired (see p. 8 fn., *supra*), consideration of Judge Friendly's suggestion of a rule to avoid "making such *ad hoc* judgments" may now be appropriate.

The "three-pronged test" which proved so easy of application in the special circumstances of *Kohn*, as an anti-discrimination case under Rule 23(b)(2), and *General Motors*, with its $112,000,000 private claim,—and, it is submitted, which should also be easy of application in the case at bar with plaintiff's claim of less than $5,000,—could present difficulty in seeking to apply what may become extraordinarily indeterminate concepts, particularly as to the first two prongs.

Few cases are as clear as *General Motors* with respect to the first prong, since a plaintiff's individual claim of $112,000,000 obviously rendered the suit viable as a private action. The problem arises primarily in the kind of class actions which Judge Lumbard has stated "plagued" this

Court, and which were described by Judge Friendly as according "minuscule" "benefits to the individual class members" and brought merely to compel a settlement which will "yield compensation to the plaintiffs' lawyers which seems inordinate" (see p. 3, *supra*).

Yet, to defeat appealability, as unsuccessfully attempted in *Herbst* (pp. 11-12, *supra*), and has also been here asserted, the Court may anticipate always being met with the assertion that the plaintiff "fully intends to continue the prosecution of this action" (Br. 10).

While the Court must realize that in this case there can be no such intent, many cases will present the question of what in fact constitutes a sufficiently sizable figure to lend credence to a plaintiff's expression of intent to continue the action as a private action. The figure would have to be at least sufficient to cover out-of-pocket disbursements, if not some compensation for counsel.

Even more indeterminate can be the second prong of whether the issues involved in a class determination are "separable from the merits." As Judge Mansfield pointed out in *General Motors*, "strict application of this condition would preclude almost any review" (p. 659), since essential to a Rule 23(b)(3) class determination are findings which necessarily impinge on the merits, such as predominance of "questions of law or fact common to the members of the class", or the superiority of a class action to other available methods for adjudicating the controversy.

In recognition of this problem, *Kohn* and *General Motors*, in applying the second prong, have used the test of "far into the merits", which requires an *ad hoc* judgment in each case as to how far is "far".

The third prong rarely presents a problem, since it is self-evident that there must be a substantial incremental cost in defending a class action, as compared with an in-

dividual action, except, perhaps, in unique situations such as *Kohn* and *General Motors*.

Finally, there could be serious doubt whether this Court's "three-pronged test" is fully consistent with Supreme Court decisions which have sustained reviewability of orders made at the outset of a case, but "fundamental to the further conduct of the case". For example, *Larson* v. *Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685, fn. 3 (1949) stated in a footnote that though "The judgment * * * was not a final one," it was appropriate for review, since the issue involved was " 'fundamental to the further conduct of the case'. See *Land* v. *Dollar*, 330 U.S. 731, 734 (1947)." Simultaneously the Supreme Court stated in the text of its opinion that this same issue "*was also one of the questions on the merits*". Nevertheless, the Supreme Court did not deem such lack of separability from the merits to be a bar to appealability.

Larson strongly supports Judge Mansfield's view in *General Motors* that not all the factors involved in the "three-pronged test" are "mandatory conditions precedent to review", and particularly his doubts as to "the second requirement—that a class certification to be appealable must be 'separable from the merits' " (501 F.2d at 659, 656).

It is respectfully submitted that Judge Friendly's suggestion of a rule of appealability which would avoid *ad hoc* judgments has substantial merit and should be adopted by this Court.

B. Any Rule Adopted by This Court Should Be in Favor of Appealability of All Orders Determining Class Action Status.

(1) The most widely-quoted statement of the collateral order doctrine is that of *Cohen* that orders are appealable as final under §1291 if they "finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too inde-

pendent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated'' (337 U.S. at 546). *Cohen* held the order there involved to be appealable ''because it is a final disposition of a claimed right which is not an ingredient of the cause of action and does not require consideration with it'' (pp. 546-7).

However, despite such limitations, as stated in *Cohen,* appealability has been sanctioned by the Supreme Court in situations where it was felt that an issue was too important to be denied review and that it was undesirable to require deferral of appellate consideration,—even where the issue appeared to be ''an ingredient of the cause of action'' and to ''require consideration with it'' rather than ''separable'' or ''collateral''.

Thus, a ruling which sustained an objection to certain evidence offered by a party in a condemnation case was held appealable, on the theory that such a ruling on evidence was ''fundamental to the further conduct of the case'' (*United States* v. *General Motors Corp.,* 323 U.S. 373, 377 (1945)).

Similarly, even after *Cohen,* the doctrine was applied to authorize appealability, in a suit for wrongful death, based on the Jones Act, general maritime law and state statute, of an order which struck from the complaint all allegations referring to unseaworthiness or the state statute, because ''the requirement of finality is to be given a 'practical rather than a technical construction' '', and because it was economically desirable to have such questions resolved at the outset, since they were '' 'fundamental to the further conduct of the case.' '' (*Gillespie* v. *United States Steel Corp.,* 379 U.S. 148, 152, 153 (1964)).

Although in these two cases the order appealed from was not ''separable'' or ''collateral'' and was ''an ingredient of the cause of action'', the Supreme Court nevertheless sustained appealability because the issues involved

were so significant as to inevitably affect the course and outcome of the case.*

(2) Whether a case should proceed as an individual private action or class action is clearly an issue "separable from, and collateral to, rights asserted in the action," as so unequivocally held in *Eisen III* (p. 1007, fn. 1). It is clearly "a final disposition of a claimed right which is n t an ingredient of the cause of action and does not require consideration with it" (*Cohen*, at 546-7). As this Court also held in *Eisen III*, "An order sustaining a class action allegation clearly involves issues 'fundamental to the further conduct of the case'" (p. 1009, fn. 1). Indeed, as Judge Mansfield stated in *General Motors*, because of the extent to which such an order "dramatically affects the course and conduct of a case", "it would be difficult to imagine an order more fundamental to the conduct of a case than one which certifies a class action" (p. 659, fn. 3).

On the other hand, in view of "the consequences of unleashing the titanic class action weapon", this Court

* In other situations, the Supreme Court has authorized appealability of issues which constitute "claims of right separable from, and collateral to, rights asserted in the action", and "not an ingredient of the cause of action." Examples are the issues involved in *Cohen* of the plaintiff's obligation in a stockholders' derivative action to post security for costs; of an order vacating an attachment in admiralty (*Swift & Co.* v. *Compania Caribe*, 339 U.S. 684, 688-9 (1950)); an order denying a petition to proceed *in forma pauperis* (*Roberts* v. *U.S. District Court*, 339 U.S. 844, 845 (1950)); an order granting or reviewing consolidation of actions (*MacAlister* v. *Guterma*, 263 F.2d 65, 66-67 (2d Cir. 1958)); and many others arising in a variety of situations.

While the most frequent application of the *Cohen* collateral order doctrine relates to appeals under §1291 of orders which are not final in the sense of being "the last order possible to be made" in the case (*Gillespie* at 152), it has also been applied by the Supreme Court to orders under §1257, where review is limited to "Final judgments or decrees rendered by the highest court of a State". See *Construction Laborers* v. *Curry*, 371 U.S. 542, 549 (1963); *Mills* v. *Alabama*, 384 U.S. 214, 217 (1966); *Richfield Oil Corp.* v. *State Board*, 329 U.S. 69, 72-74 (1946); *Pope* v. *Atlantic Coast Line R. Co.*, 345 U.S. 379, 381-383 (1953).

"should not allow this complex, time-consuming and expensive process to be launched without ample justification". This Court should prescribe a rule which will prevent "imposing an unnecessary and staggering burden upon the district courts and in delaying justice until the central issue becomes academic" (*General Motors,* at 660, 658). This is best accomplished through immediate appeal of orders granting class action status, rather than a rule which may "require that appellate consideration be deferred until the whose case is adjudicated" (*Cohen,* at 546).

As also stated in *Herbst,* "it is desirable for us to review orders authorizing class actions before the parties and the district courts expend large amounts of time and money in managing them" (495 F.2d at 1313).

While there may be an understandable reluctance to open the way to the additional appeals which might result from a rule making all class determination orders appealable, the end result could well be a substantial easing of the over-all judicial burden. For, as also stated in *Herbst,* "immediate review of orders authorizing class actions will aid the district courts in disposing of these cases and promote the sound administration of justice" (495 F.2d at 1312).

Conclusion

It is respectfully submitted that:

(1) This Court should hold that the District Court's order granting class action standing is appealable.

(2) This Court should adopt a rule in favor of appealability of all orders determining class action status.

(3) This Court should make the other determinations requested in Andersen's original brief.

Dated: New York, New York
April 29, 1975

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- -x

JAY HANDWERGER,

Plaintiff-Appellee,

-against-

CHARLES GINSBERG, JR., DAVID WEINTRAUB, ABRAHAM WEINTRAUB, et al.
Defendants

ARTHUR ANDERSEN & CO.,
Defendant-Appellant

- -x

AFFIDAVIT OF SERVICE ON PERSON IN CHARGE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

MORRIS SOLODOFF being duly sworn, says: I am employed in the office of Breed, Abbott & Morgan, 1 Chase Manhattan Plaza, New York, N.Y. 10005, attorneys for the defendant-appellant in the above action.

On the 29th day of April , 1975 , between the hours of 9:30 A.M. and 5:30 P.M., I served the annexed

REPLY BRIEF

on the attorney(s) listed below by delivering the same to and leaving the same with the person in charge of said office(s).

Milberg & Weiss, Esqs., Attorneys for Plaintiff-Appellee
One Pennsylvania Plaza, New York, N.Y. 10001

Sworn to before me this
29th day of April, 1975

Donald L. Price

DONALD L. PRICE
NOTARY PUBLIC, State of New York
No. 24-8439300
Qualified in Kings County
Certificate Filed in New York County
Commission Expires March 30, 1976

Morris Solodoff